

Impact of the COVID-19 pandemic on global FDI and value chains – opportunities and challenges for investment attraction measures of the Republic of Moldova

Bjoern Vogler and Carolin Busch

Berlin/Chişinău, February 2021

Outline

1. Introduction
2. Impact of the COVID-19 pandemic on global FDI and value chains
3. Competitive position of Moldova
4. Conclusions and recommendations for investment attraction measures

1. Introduction

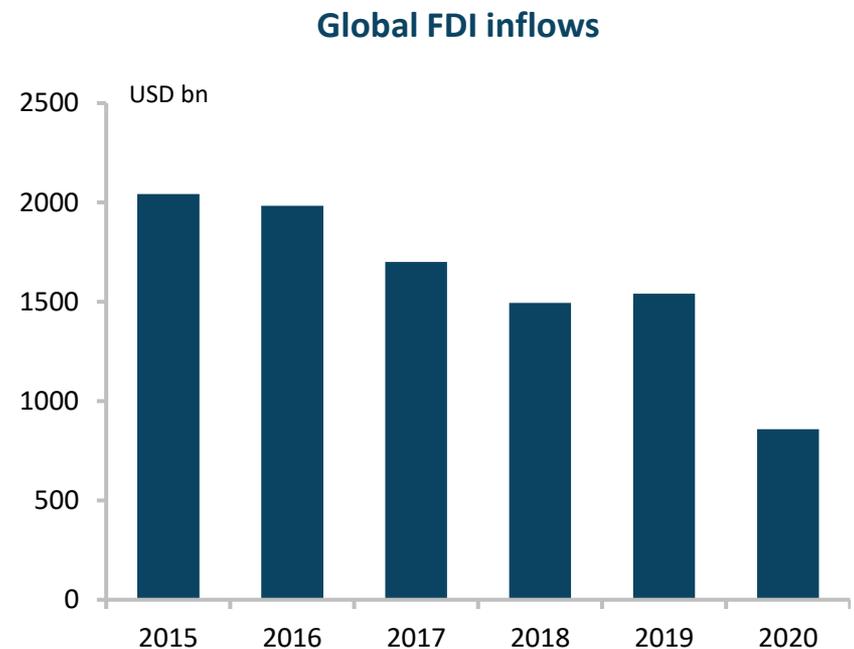
This policy briefing examines the COVID-19 related impact on global FDI and value chains. Particular emphasis is on identifying opportunities for investment attraction measures in the context of the transformation of global value chains

- Investment is central to growth and sustainable development
- However, current conditions are challenging, with global FDI declining in recent years and the severe impact of the COVID-19 pandemic on investment flows and global value chains (GVCs)
- At the same time, the transformation of international value chains that has been accelerated by the pandemic is not without opportunities
- Those go beyond attracting nearshoring projects, which are currently in the focus of investment promotion practitioners around the globe
- Against this background, this policy briefing reviews emerging trends affecting the future configuration of global value chains
- Furthermore, it assesses Moldova's competitive position in light of this transformation process as a basis for recommendations on investment attraction measures

2. Impact of the pandemic on global FDI and value chains

Global FDI flows were already declining in the second half of the past decade. In addition, the COVID-19 pandemic had a severe impact on FDI and international value chains

- Global FDI flows are under severe pressure as a result of the pandemic
- According to UNCTAD, FDI decreased by 42% in 2020 at the global level and by 28% in South-East Europe
- Export-oriented and commodity-linked investments are among the most seriously affected
- Global FDI flows are projected to fall by a further 5 to 10% in 2021
- Growth in FDI inflows is not forecast to return before 2022



Source: UNCTAD 2020

2. Impact of the pandemic on global FDI and value chains

The transformation of global value chains and FDI patterns constitutes a long-term process which already started before the COVID-19 pandemic and will continue throughout this decade

- Following two decades of rapid expansion, GVC-related investment in physical assets already stopped growing after 2010
- Tech-driven investments which do not need a large physical presence became more important
- Between 2010 and 2019, the number of FDI greenfield projects in the ICT industry increased by close to 70% – from 1,989 to 3,332 projects
- In 2019, the ICT industry accounted for 18.2% of the global total of greenfield FDI projects – compared to 12.8% in 2010

Top 10 FDI industries by number of greenfield projects in 2019

	Industry	Projects
1.	Information and communication	3,332
2.	Textiles, clothing and leather	1,519
3.	Computer, electronics, optical products	1,201
4.	Professional, scientific and technical activities	1,088
5.	Financial and insurance activities	1,028
6.	Motor vehicles and other transport equipment	1,022
7.	Administrative and support service activities	954
8.	Manufacture of machinery and equipment	855
9.	Transportation and storage	764
10.	Manufacture of chemicals / chemical products	752

Source: fDi Markets 2020

2. Impact of the pandemic on global FDI and value chains

The COVID-19 pandemic is accelerating a range of pre-existing trends strongly affecting the configuration of global value chains

- The transformation of international value chains is expected to continue driven by technological changes – e.g. the digital transition and advanced manufacturing – as well as global economic governance and sustainability trends
- In addition, companies are reviewing where products are sourced, where each activity is located and how value chains are operated to increase resilience to future shocks
- The combination of pre-existing trends with the resilience-oriented restructuring will shape the future configuration of global value chains
- While there will be more focus on resilient and sustainable value chains, cross-border investment in physical assets is expected to decline further
- Efficiency-seeking investment will continue to play an important role in global FDI patterns. However, the pool of this type of investment is shrinking

2. Impact of the pandemic on global FDI and value chains

Despite several challenges such as relocations, a shrinking pool of efficiency-seeking investment and tougher competition, the transformation process also opens up new opportunities for investment attraction

- Opportunities go well beyond attracting re- and nearshoring projects, which
 - entail a relocation and concentration of activities in hubs at or close to home
 - are currently in the focus of investment promotion practitioners around the globe
- Drawing on the latest World Investment Report, the following further scenarios for the future configuration of value chains can be identified, which also offer promising investment and development potentials:
 - **Diversification:** a wider international distribution of locations and suppliers leveraging digital technologies for the coordination of value chains
 - **Regionalisation:** a shift from global efficiency-seeking investment to regional market-seeking investment and from investment in vertical segments to investment in broader industrial bases and clusters
 - **Replication:** characterised by distributed manufacturing close to the point of consumption using advanced production technologies, e.g. additive manufacturing

2. Impact of the pandemic on global FDI and value chains

The scenarios are not mutually exclusive. They will play out to varying extents across industries. The direction and intensity of the transformation process depends on how companies balance risk-mitigation with cost-efficiency

The scenarios are likely to affect in particular the following types of industries:

- Nearshoring: higher-technology GVC-intensive industries
- Diversification: low-tech GVC-intensive industries, higher value added services
- Regionalisation: extractive and regional processing industries
- Replication: not widely applicable, certain relevance for global hub and spokes industries and application industries for additive manufacturing technologies

Relevance of the scenarios for selected industries

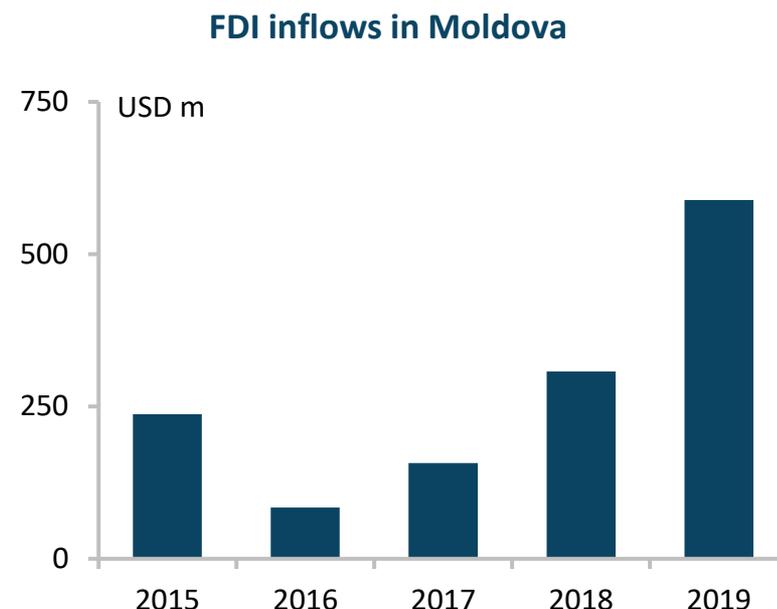
Re- / Nearshoring	Diversification	Regionalisation	Replication
Machinery and equipment Electronics	Textiles and apparel Financial, professional and business services	Energy, extractive and chemical ind. Food and beverages Glass, cement and ceramics	Medical devices Customised spare parts Footwear
	Wholesale, transport, logistics Automotive, transport equipment		
Pharmaceuticals, biotechnology, healthcare			

Source: UNCTAD 2020; own research

3. Competitive position of Moldova

In the recent past, Moldova has proven to be a competitive investment location attracting a wide spectrum of FDI projects

- Bucking the global trend, Moldova could significantly increase FDI inflows in the second half of the past decade, although from a low base
- In particular, export-oriented projects, e.g. in the automotive supply industry, could be attracted, fostering the integration into global value chains
- Amongst others, the following strengths contributed to the strong track record:
 - Strategic geographic location and access to key markets
 - Competitive operational costs
 - Industrial tradition



Source: UNCTAD 2020

3. Competitive position of Moldova

Moldova also made progress in terms of upgrading in international value chains and promoting linkages between investors and local enterprises and institutions

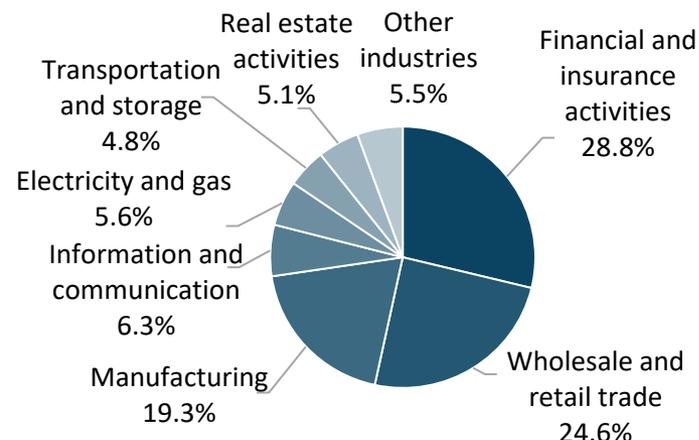
- Not only the quantity, but also the quality and impact of attracted investment could be increased in the recent past
 - For instance, the establishment of a product development office by the German Dräxlmaier Group constitutes an example of a research-oriented investment project that could be attracted to Chisinau
 - In addition, a number of IT-related projects could be secured in recent years
- Furthermore, progress has been made in terms of promoting linkages and integrating foreign investors in cluster development initiatives
 - For instance, an automotive cluster comprising approximately 25 companies, various universities and service providers has been established
 - Foreign investors such as Dräxlmaier, Fujikura, Coroplast and Confezione Andrea play an import role in the cluster initiative
 - In addition to collaborative innovation and vocational training projects, a supplier development programme is part of the cluster-related activities integrating local SMEs into international value chains

3. Competitive position of Moldova

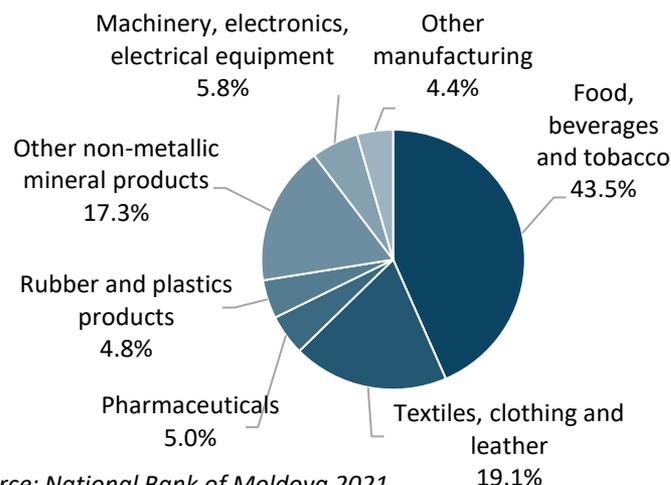
Despite those successes, cluster development is still at an early stage and there is a rather strong focus on low- and medium-tech industries and value chains

- Competing locations, in particular in Asia, have been more successful in promoting linkages and extracting value from FDI in terms of skills and supplier development
- There has been a strong focus in the recent past on vertical specialisation and efficiency-seeking investments, concentrating on specific segments in low- and medium-tech value chains
- Knowledge- and technology-oriented industries still account for a low share of overall and manufacturing FDI in Moldova

FDI stock (equity) in Moldova by industries 2019



Manufacturing FDI stock (equity) in Moldova 2019



Source: National Bank of Moldova 2021

4. Conclusion and recommendations

Despite several challenges such as the shrinking pool of efficiency-seeking investment, the transformation of international value chains is not without new opportunities and, in principle, Moldova is well positioned to benefit from them

- Building upon its track record in attracting investment as well as its existing strengths such as the location at the doorstep to EU, the cost-competitive labour force and industrial tradition, Moldova is in a favourable position
- However, success will neither come automatically nor overnight
- The transformation of value chains constitutes a trend that started in the last decade and will continue throughout this decade. It is a lengthy and complex transformation process which requires a strategic and long-term response
- Efforts need to be intensified to
 - fully unlock investment and development potentials in the context of the transformation of international value chains in quantitative and qualitative terms
 - keep pace with the transformation process that has been accelerated by the COVID-19 pandemic

4. Conclusions and recommendations

The transformation of international value chains will bring several opportunities for the development of Moldova's economy which go beyond attracting nearshoring projects

Scenario:

Related value chains / target groups:

Opportunities for Moldova:

Re- / Nearshoring

EU investors relocating and concentrating activities in hubs at or close to their home countries – in particular in higher-technology value chains



- Attracting investment from new target groups
- Developing new value chains and industries (e.g. electronics, machinery)

Diversification of international value chains

Large international investors diversifying their locations and value chains, increasingly adopting digital solutions – in particular in higher value services



- Further diversifying target groups / economic structure
- Developing Moldova as BPO and IT hub

Building up regional value chains

Large international investors replicating operations and value chains in regions of strategic importance – in particular in regional processing industries



- Upgrading regional value chains (e.g. agro-processing, construction material)
- Fostering linkages between investors and local SMEs

4. Conclusions and recommendations

However, competition will intensify and investors will become more demanding preferring locations with established cluster structures. Tapping the potentials of the transformation process requires a targeted and coherent approach

- **Focusing on value chains that offer the most promising potential:**
 - There is a need to assess carefully which value chains / industries are offering the most promising potential in light of the transformation process
 - Targeted investment promotion efforts should be intensified focusing on a realistic number of value chains / industries based on this review
- **Using synergies between investment attraction and cluster development:**
 - All transformation trends entail a need for the development of clusters and industrial ecosystems to extract more value from investment and increase the attractiveness from the perspective of new investors
 - Particular emphasis should be placed on strengthening the skills base, the digital capacity and infrastructure as well as on promoting linkages between investors, local suppliers, educational and research institutions
 - A systematic aftercare approach has proven helpful to foster linkages and to integrate international investors in cluster development initiatives

4. Conclusions and recommendations

Tapping the potentials of the transformation process requires a targeted and coherent approach (cont.)

- **Aligning relevant policy tools:**
 - An ecosystem- or cluster-based approach is highly complex and requires the alignment of various policy tools and areas
 - With respect to investment policy tools, this relates, amongst others, to developing a needs-oriented portfolio of investment sites – including innovation and technology parks – and refining the incentive framework focusing more strongly on linkages and skills development
 - To maximise the impact, it is important to align further policy areas such as entrepreneurship, innovation, education and training accordingly and to ensure effective inter-institutional coordination
- **Ensuring adequate resources and capacities:**
 - Such a targeted and cluster-based approach relies on specific expertise, e.g. for identifying and promoting promising value chains, as well as coordination skills
 - Fluctuation should be avoided as it represents a major impediment for developing the necessary capacities, customer relations and contact networks

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economics has been commissioned with the implementation of the consultancy.

CONTACT

Carolin Busch, Project Manager Moldova
busch@berlin-economics.com

German Economic Team
c/o BE Berlin Economics GmbH
Schillerstraße 59
10627 Berlin

Tel: +49 30 / 20 61 34 64 0
info@german-economic-team.com
www.german-economic-team.com

Implemented by

